STANDARD & POOR'S

PUBLIC FINANCE

King County, Washington

Credit Profile		
US$41.52 mil Lmtd tax GO Bond Anticipation Notes ser 2007 due 10/30/2008		
Short Term Rating	SP-1+	New
US$30.835 mil Lmtd Tax GO bnds ser 2007D		
Long Term Rating	AAA/Stable	New
US$18. mil Lmtd Tax GO bnds ser 2007C due 01/01/2028		
Long Term Rating	AAA/Stable	New
King Cnty GO		
Long Term Rating	AAA/Stable	Affirmed

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Rationale

Standard & Poor's Ratings Services assigned its 'AAA' rating to King County, Wash.'s $18 million series 2007C and $30.8 million series 2007D limited-tax GO (LTGO) bonds. In addition, Standard & Poor's assigned its 'SP-1+' short-term rating to the county's $41.5 million in LTGO bond anticipation notes. Standard & Poor's also affirmed its 'AAA' rating on King County, Wash.'s approximately $1.8 billion in previously issued GO and LTGO bonds. The 'AAA' rating reflects the county's exceptional financial management through the spectrum of economic climates. Being confronted with revenue-raising constraints, the county engages in sophisticated and conservative revenue planning that results in very accurate actual-to-budgeted performance. On the expense side, the county has effectively controlled cost growth rates and continues to actively pursue expense growth rate reductions in stubborn cost areas such as employee health care. At this time, the county has balanced its budget for fiscal 2008 without needing to implement target level (across-the-board) budget reductions while continuing to address out-year projections of budget stress. Recognizing the need for financial cushion in its limited revenue flexibility environment and when economic growth attenuates, management has in recent years incrementally increased reserve levels. The rating additionally reflects:

- An exceptionally broad and deep economic base that, though it appears to be in a fully mature phase of the business cycle, shows few indications of a significant slowdown in any of the region's important industrial sectors;
- A very large and growing tax base with strong income measures;
- Very strong financial management despite a limited capacity to raise revenues; and
- Moderate debt levels that are considered affordable given county incomes.

The county's GO bonds are secured by either limited-tax or unlimited tax pledges. Total overlapping and direct debt remains moderate at $2,936 per capita and 1.80% of 2007 total property value. Through 2008, the county anticipates issuing $150 million in limited-tax GO bonds.

Several years of particularly strong economic and revenue growth have masked the county's underlying structural misalignment between revenues and expenditures that is caused by a constitutional 1% limitation to property tax revenue growth (not including newly constructed development), which is the largest revenue source at 40% of the total general fund revenues. Nevertheless, as it has since 2005, the county again experienced robust revenue performance in 2006. Sales tax revenues, which had declined 7.2% from 2000 to 2003, increased 7.1% in fiscal 2006 and are on track to increase another 6.4% in 2007. Overall, 2006 revenues in the general fund grew 2.7% higher than budgeted and key revenues are tracking ahead of budget for 2007. These positive results have effectively eliminated the structural budget gap for fiscal 2006 and have led to a small projected surplus in 2007, though projections for fiscals 2008 and 2009 indicate deficits of up to 2.9%, predicated on our assumption that the economy will enter a period of slow or flat growth.

On an audited basis for fiscal 2006, the county ended with an unreserved general fund balance of $119.5 million or 20% of expenditures plus transfers. Reserves increased significantly in fiscals 2004 and 2005, reflecting a very strong revenue environment in those years and in anticipation of certain known cost increases and one-time expenditures over the next two fiscal years (2006 and 2007). As components to the unreserved general fund balance, the county has designations for anticipated increased pension contribution costs as well as to maintain its $10 million annexation reserve (currently at $7.7 million). This latter reserve is intended to provide transitional funding, and therefore incentive, for unincorporated urban areas to incorporate or annex into existing cities, relieving the county of providing certain urban-associated services. In August, two areas encompassing a total of 15,000 residents voted to annex into the City of Auburn. At the same time, an annexation measure for an unincorporated area to annex into the city of Federal Way was defeated. In November 2007, the Benson Hill community, representing about 16,400 residents is holding an election regarding annexing into the city of Renton. State legislation from 2006 allows cities that execute annexations of more than 10,000 residents a credit equivalent to a 0.1% sales tax rate that would otherwise go to the state to be retained in local coffers for 10 years—a clear incentive for annexation approval. The county projects that as many as 193,000 residents may be annexed into cities by 2010, which is likely to have a favorable budget impact since the cost of service to these presently unincorporated residents exceeds the revenues generated by retail and commercial activity in these areas.

King County's management practices are considered 'strong' under Standard & Poor's financial management assessment (FMA). An FMA of 'strong' indicates that practices are strong, well embedded, and likely sustainable. Practices and policies are well established in almost all areas. Revenue and expenditure forecasts are based on historic performance and modeled by a dedicated staff economist. Long range financial forecasting is formally performed for the budget year and then two pro forma years. A rolling six-year capital plan is maintained with identified funding sources for all anticipated projects. In 1984, the county established a 6%-8% of general fund expenditures reserve policy.

King County, with a population of 1.8 million, is Washington's most populous county. One-third of its residents live in Seattle, the Pacific Northwest's economic center. The county's economy is expanding with a broad-based job growth across sectors, particularly in the information technology. Construction employment, though still growing, is doing so at a lower rate while manufacturing employment continues to expand as well. Job growth in manufacturing reflects increased employment in aerospace thanks to strong orders for aircraft at Boeing. Leading employers continue to include Boeing (68,200 employees), Microsoft (30,300), University of Washington (21,400), King County (12,400), and the City of Seattle (10,400). Income levels remain strong with median household and per capita effective buying incomes at 123% and 138% of the nation.

Through 2008, the county anticipates issuing up to $150 million in additional limited-tax GO bonds. To address the sizable capital plan associated with the county wastewater system, $1 billion in debt over the remainder of the decade is expected. Net revenues of the sewer system will secure this debt with a portion additionally secured by the county limited tax GO pledge as well. On a per capita basis, debt is moderate at $2,936 and is 1.80% of total market value.

Outlook

The stable outlook reflects the county's demonstrated capacity for excellent financial management through a spectrum of economic cycles. The outlook also reflects that the county, as a matter of practice, performs thorough multiyear financial forecasting and has shown the willingness and ability to make substantive spending reductions when necessary in order to maintain budget balance as well as to adhere to its own reserve policies. At the current rating level, the county's responsiveness and ability to enact expenditure reductions is critical, given our view that the current regional economic expansionary cycle has fully matured and thus positioned the county for flattened or slightly reduced revenue growth in the next 1-2 years.

Economy Is Robust; Susceptible To Periods Of Volatility

County economic performance's apparent mature phase comes on the heels of a gradual and sustained expansionary phase that followed the protracted, deep three-year economic slowdown that started in 2001. During that recession, the regional economy, based in aerospace and high-tech, was impacted severely due to the performance of those industries nationally. Economic acceleration through 2005 was fueled by expansions in these same sectors as well as the notably robust construction industry, which responded to favorable conditions of low interest rates and strong demand in the national and local MSA housing markets. More recently, construction employment is showing signs of diminished growth rates (7.6% year over year in December 2006), offset to a degree by increased growth rates in the information sector (up 8.3%). Overall employment was still expanding through 2006 with an increase of 3.3% in total jobs for the year, though early indications that job growth in 2007, while still positive, is more subdued at approximately 1.5%.

In contrast to much of the nation, the Seattle-Tacoma MSA is not experiencing a noticeable downturn in the real estate market, even if new construction trends and prices have flattened somewhat. Whereas the S&P/Case-Shiller national housing index composite shows a steep 3.9% decline in median sales price for existing single-family residences (July 2007, year over year), the same index for the Seattle-Tacoma market is up 6.9%.

With rapidly expanding Asian economies and a globally revived airline industry, Boeing, the region's largest employer, received a record 1,044 aircraft orders in 2006, which is contributing to a sixth year (in 2007) of job expansions at the firm after several years of significant job reductions early in the decade. Putting the magnitude of Boeing's prior pullback in perspective, however, is the company's completion of 398 aircraft deliveries in 2006, compared with 622 in 1999 and 527 in 2001. Still, this is an improvement from the low point in 2003, when just 239 deliveries were made. Moreover, future deliveries are expected to remain strong as there is intense demand for the new fuel efficient 787 Dreamliner, with first deliveries to be made around the end of the first quarter 2008, though the actual delivery date is currently in doubt in light of recently announced and relatively serious technical and production-related problems that have emerged.

In the software publishing, high-tech, and wireless technology sectors, employment trends are brisk and expected to remain so throughout 2007. While reduced job growth is expected in 2008, for 2007 total employment in the information based sectors should increase 4.9% according to GlobalInsight. Moreover, the industry leader Microsoft is moving forward with its 2.8 million square feet office complex project to accommodate 10,000-20,000 new jobs over the next 20 years.

In 2006, retail sales and use tax revenues grew by 7.1% after growing 7.7% in 2005. The recent growth in sales tax revenues is in stark contrast to the 7.2% decline from 2000 to 2003. Very low interest rates for much of this period supported the market for real estate despite the lagging general economic recovery, resulting in record real estate excise tax collections. There are early signs that the torrid pace of real estate appreciation is beginning to abate somewhat, however. Nonetheless, income levels remain strong, with per capita income at 125% of state and 138% of national averages. Median household income was 112% of state and 123% of U.S. averages. Per capita retail sales are respectively 129% and 126% of the state and national averages. Unemployment in 2006 was 4.2%, below the national average and down significantly from the 10-year high of 6.2% in 2003.

Finances Remain Strong Despite Revenue Raising Limits

A structural challenge the county has grappled with is the pressure that Initiative-747 (I-747) places on county finances. In 2001, Washington voters approved I-747, which limits the growth of tax revenues to 101% of the previous year's revenues plus newly constructed development. At present, the constitutionality of this initiative is before the state Supreme Court after the King County Superior Court ruled the initiative unconstitutional, which if upheld would remove the current levy limitation. The outcome is unpredictable. Early in the current decade, this and other limits on revenue growth combined with regular growth in expenditures to produce a structural budget gap between recurring revenues and expenses. Recurring cost control measures introduced in recent years have reduced annual recurring expenditures. For perspective, total general fund expenditure growth was 11% and 8.3% in fiscals 2000 and 2001, respectively. By fiscals 2003 and 2004, the county had reduced general fund expenditure growth to 2.7% and 1.7%, respectively. Reductions were achieved through service level reductions and a smaller total employee count, which declined to 13,565 in 2006 from 14,018 in 2002. In fiscals 2005 and 2006, total expenditure growth accelerated somewhat to 7.9% and 9.5%, respectively, as the county implemented technology and facility upgrades, a significant portion of which are nonrecurring. In 2006, recurring expenditures increased at a lower 4.1% rate. General fund recurring expenditures are currently forecast to grow 6.35% in fiscal 2007, following on the fiscal 2006 budget, which was balanced without the budget (and service level) reductions that were necessary in the early years of the decade. If economic (and thus revenue) growth slows more precipitously than currently anticipated, the county's continued responsiveness with regard to expenditure controls will be critical at the current rating level. Indeed, the county is already pursuing a secondary round of budget analysis at the departmental level and is contemplating target-level budget reductions across all departments for fiscal 2009.

Revenue growth came in at 6.1% in 2006 following on a growth rate of 6.8% in fiscal 2005. Continued strength in sales tax and real estate excise tax revenues, which were up 6.4% and 9.0%, respectively, were reflective of the ongoing broad based economic and real estate expansions in the county. The fact that property tax revenue grew of 4.85% in 2006 (well above the I-747 limit of 1%, except new development) indicates the importance of the construction sector to county finances and that this sector remained strong in 2006 though it's expected to slow in 2007 and 2008. Partially in response to the loss of property tax revenues (from I-747), the county budgets conservatively by assuming low growth in sales tax revenues and by reducing expenditures. In addition, management and staff have been creative in developing ways to make operations self-supporting and by contributing to projects that will provide increases in revenues other than property taxes. The current county $3.86 billion budget for fiscal 2007 is balanced with the general fund budget representing $624 million, an increase of just 0.5% over fiscal 2006.

Financial Liquidity Is Consistent

Viewed from both a balance sheet and investment portfolio perspective, county finances demonstrate consistently high levels of liquidity. Based on audited results for fiscal 2006, the county cash position in its general fund was $122.5 million, only down slightly from 2005, when cash was at $124.7 million. Cash and short-term investments to current liabilities is a strong 2.08x.

Investments are overseen by the county's Executive Finance Committee (EFC) and entail investing both the county's cash and that of 120 special purpose districts located within the county's boundaries. The investment pool, which is rated 'AAAf/S1' is managed in two distinct portfolios; a liquidity portfolio and a core portfolio. Policies restrict average maturities to 120 days in the liquidity portfolio, though at June 30, 2007, the balance in this portfolio was $2.9 billion with an average maturity of just 49 days. In the core portfolio, securities may not have average maturities of more than five years, though at June 30, 2007 the balance in the core portfolio stood at $995 million with an average duration of 1.8 years. In summary, at June 30, 2007, the investment pool had a market value of $3.896 billion, which was more than 99.8% of the pool's book value. While the county participates in the reverse repurchase ("repo") market in an effort to enhance portfolio returns, it follows policies limiting its exposure to no more than 20% of the pool's total balance. In practice, the county's exposure is actually much lower. Throughout 2006, the maximum amount of repurchase agreements in effect at any given time was 9.1% of the portfolio's total balance. Reverse-repos outstanding have further declined throughout 2007 and in August 2007, the pool is only 1.2% leveraged.

In August 2007, a rating lowered to 'A-3' from 'A-1+' on one of the county's $53 million CP holdings (Mainsail II Ltd., now rated 'B/Watch Neg') led the county to segregate that asset from the pool and allow potential losses to accrue to the county general fund with the intention of protecting the value of the pool. Under a worst-case loss scenario, the county estimates the holding could decline by $8 million in value, an amount that, if contained to this event, would, on its own, be unlikely to weaken the county's credit quality in a material way. When the EFC voted to shift any potential loss related to Mainsail II Ltd. to the general fund from the pool, it also voted that if the rating on any additional CP holdings were lowered to speculative grade, Mainsail II (and associated losses) would be put back into the pool, apparently intending to limit the county's protective measures on behalf of the pool to this one-time action. The EFC further revised investment policies to prohibit the county investment officer from making additional investments in CP without EFC reauthorization. As existing CP holdings mature, this asset type represents a declining portion of the fund's overall allocation, and is down to 17.9% of the portfolio in September from 25% in August.

Financial Management Assessment: 'Strong'

King County's management practices are considered 'strong' under Standard & Poor's financial management assessment (FMA). An FMA of 'strong' indicates that practices are strong, well embedded, and likely sustainable. Practices and policies are well established in almost all areas. Revenue and expenditure forecasts are based on historic performance and modeled by a dedicated staff economist. Long range financial forecasting is formally performed for the budget year and then two pro forma years. A rolling six-year capital plan is maintained with identified funding sources for all anticipated projects. In 1984, the county established a 6%-8% of general fund expenditures reserve policy.

Debt And Other Liabilities

Of the county's approximately $1.8 billion in outstanding LTGO and UTGO debt, $902 billion is supported by non-property tax revenues, leaving a net, tax-supported LTGO and GO total debt outstanding amount of $921 million. In addition, the county has liabilities associated with pensions and other post-employee benefits. County pensions are managed by the state, which does not disclose funding ratios for participating agencies, though the county has a strong record of making its full annual required contribution. Statewide, the Public Employees Retirement System is only adequately funded (plan assets-to-actuarial accrued liability) as of the most recent actuarial report from 2005, at 71%. The county is also exposed to liabilities associated with retirement health care benefits, though the plan providing lifetime benefits to employees is now closed. Additional liability is associated with county retirees having the option to purchase insurance at the county rate (an implicit rate subsidy). The county intends to comply with GASB-45 and is currently conducting its actuarial study.

Ratings Detail (As Of 27-Sep-2007)		
King Cnty lse (Broadway Office Prop) ser 2002 (MBIA)		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed
King Cnty ltd tax go bnds (payable from swr revs) ser 2005		
Long Term Rating	AAA/Stable	Affirmed
King Cnty GO RFD (MBIA)		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed

Ratings Detail (As Of 27-Sep-2007) (cont.'d)		
King Cnty GO (AMBAC)		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed
King Cnty GO (FGIC)		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed
King Cnty GO (FSA)		
Unenhanced Rating	AAA(SPUR)/Stable	Affirmed
King Cnty Lmtd tax GO Bond Anticipation Notes ser 2007 due 10/30/2008		
Short Term Rating	SP-1+	New Rating
King Cnty Lmtd Tax GO bnds ser 2007C due 01/01/2028		
Long Term Rating	AAA/Stable	New Rating
King Cnty Lmtd Tax GO bnds ser 2007D		
Long Term Rating	AAA/Stable	New Rating